

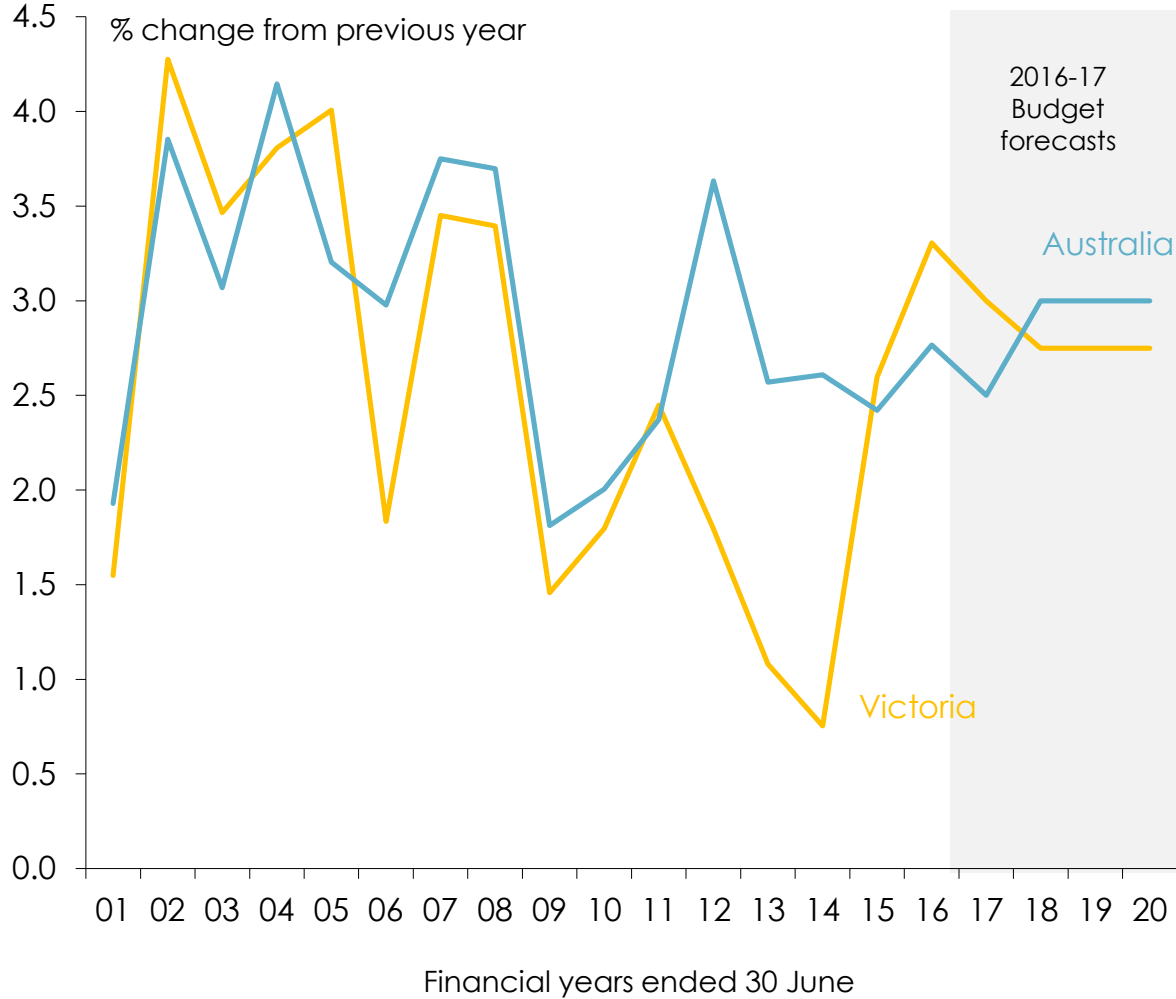
THE IMPORTANCE OF PRODUCTIVITY GROWTH AS A DRIVER OF VICTORIA'S ECONOMY

PRESENTATION TO MEMBERS OF THE PARLIAMENT OF VICTORIA

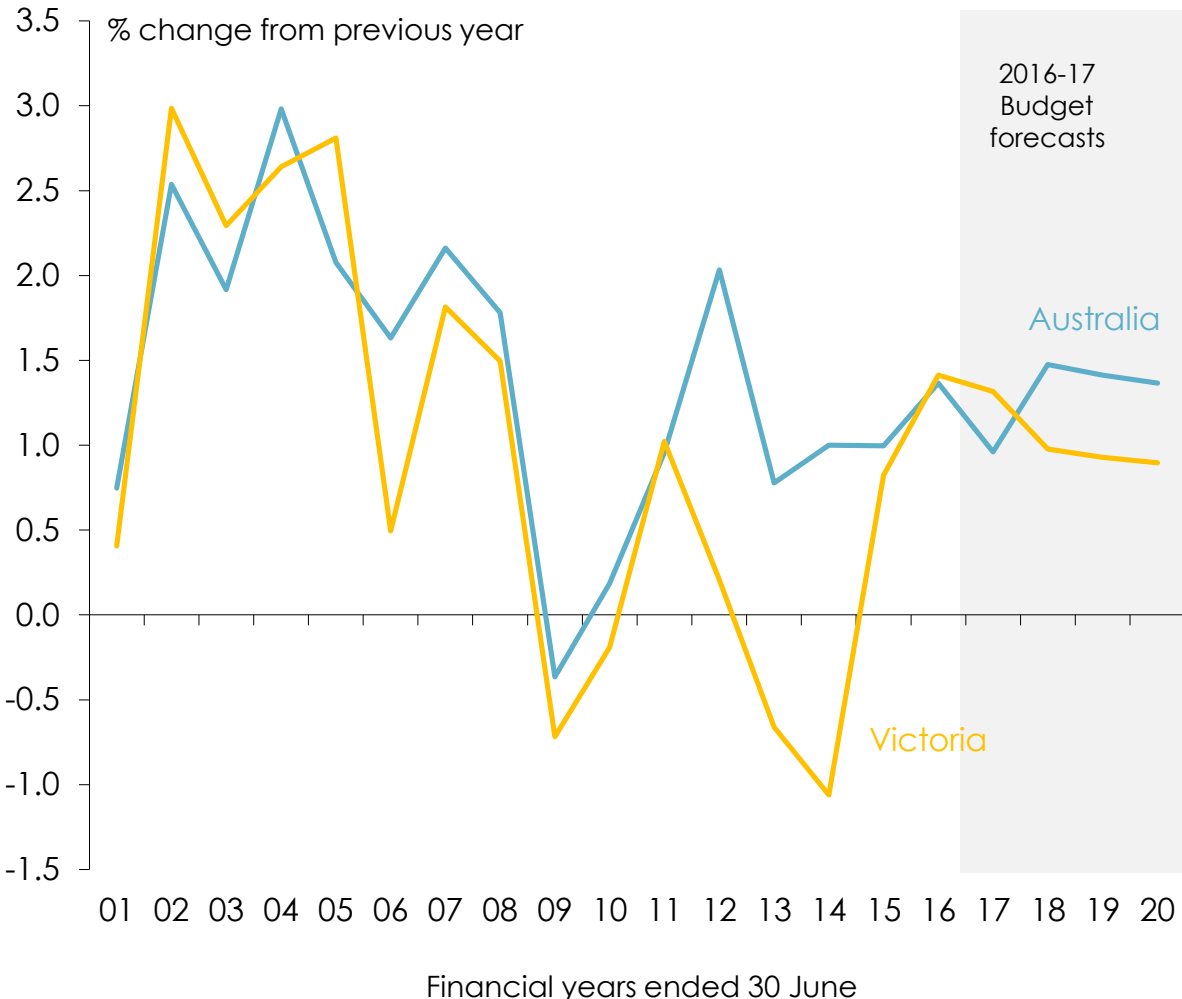
MELBOURNE – 24TH NOVEMBER 2016

Victoria's economy is picking up after under-performing the national economy during the mining boom – but will it last?

Real gross State product



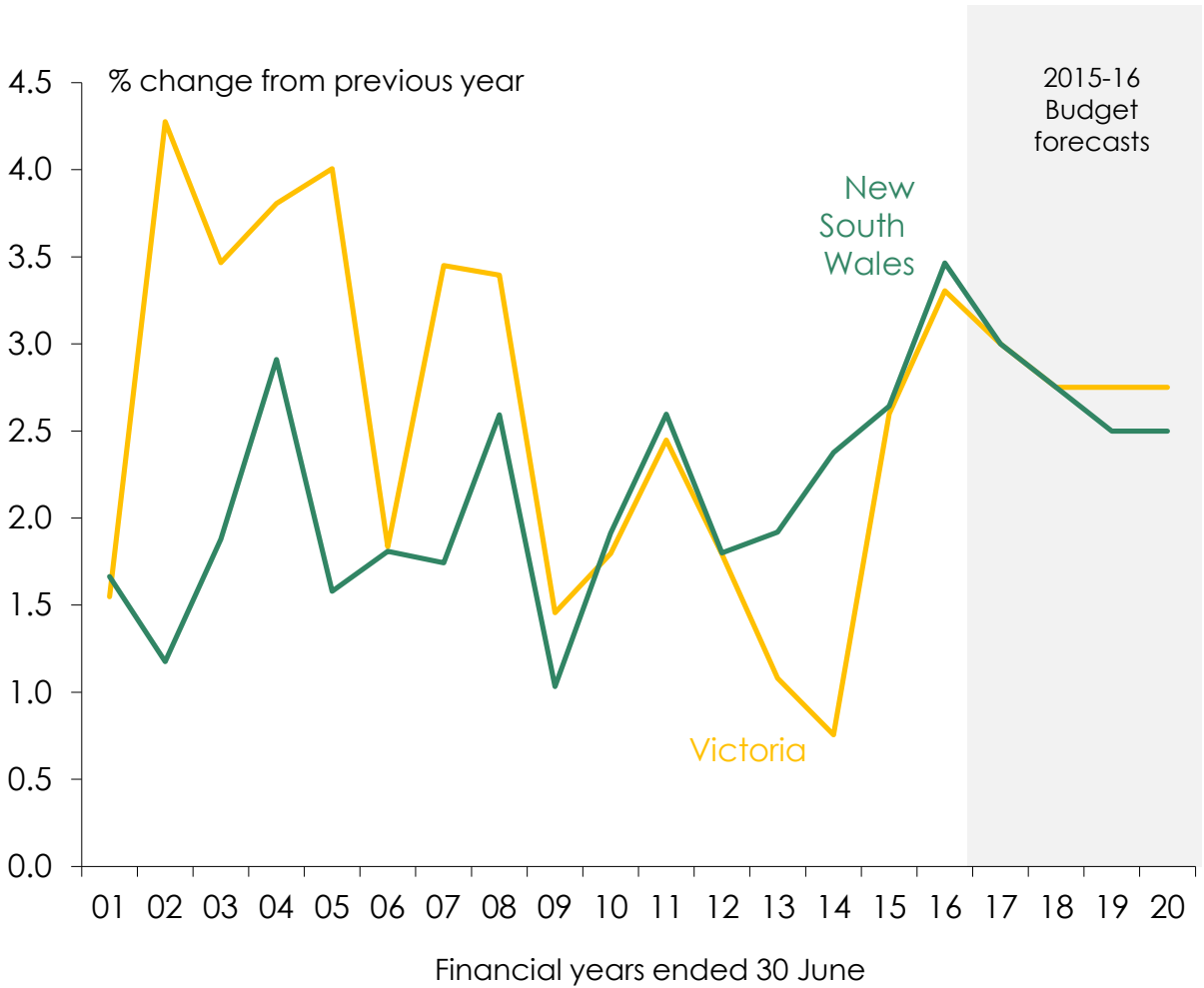
Real gross State product per capita



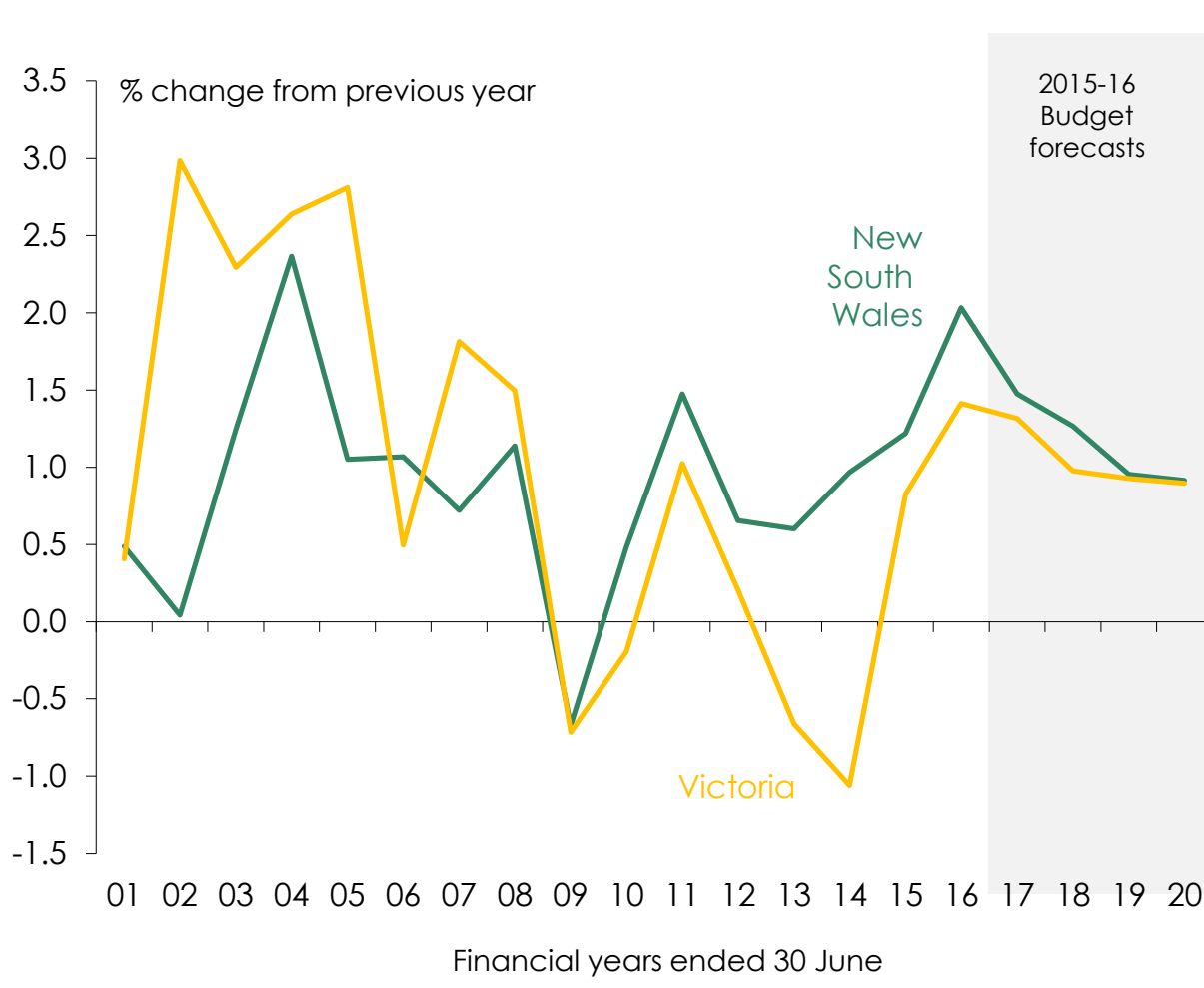
Source: ABS 5206.0 and 5220.0; Australian and Victorian Government 2016-17 Budget Papers.

New South Wales has been doing better on economic growth than Victoria so far this decade – and is forecast to keep out-performing

Real gross State product



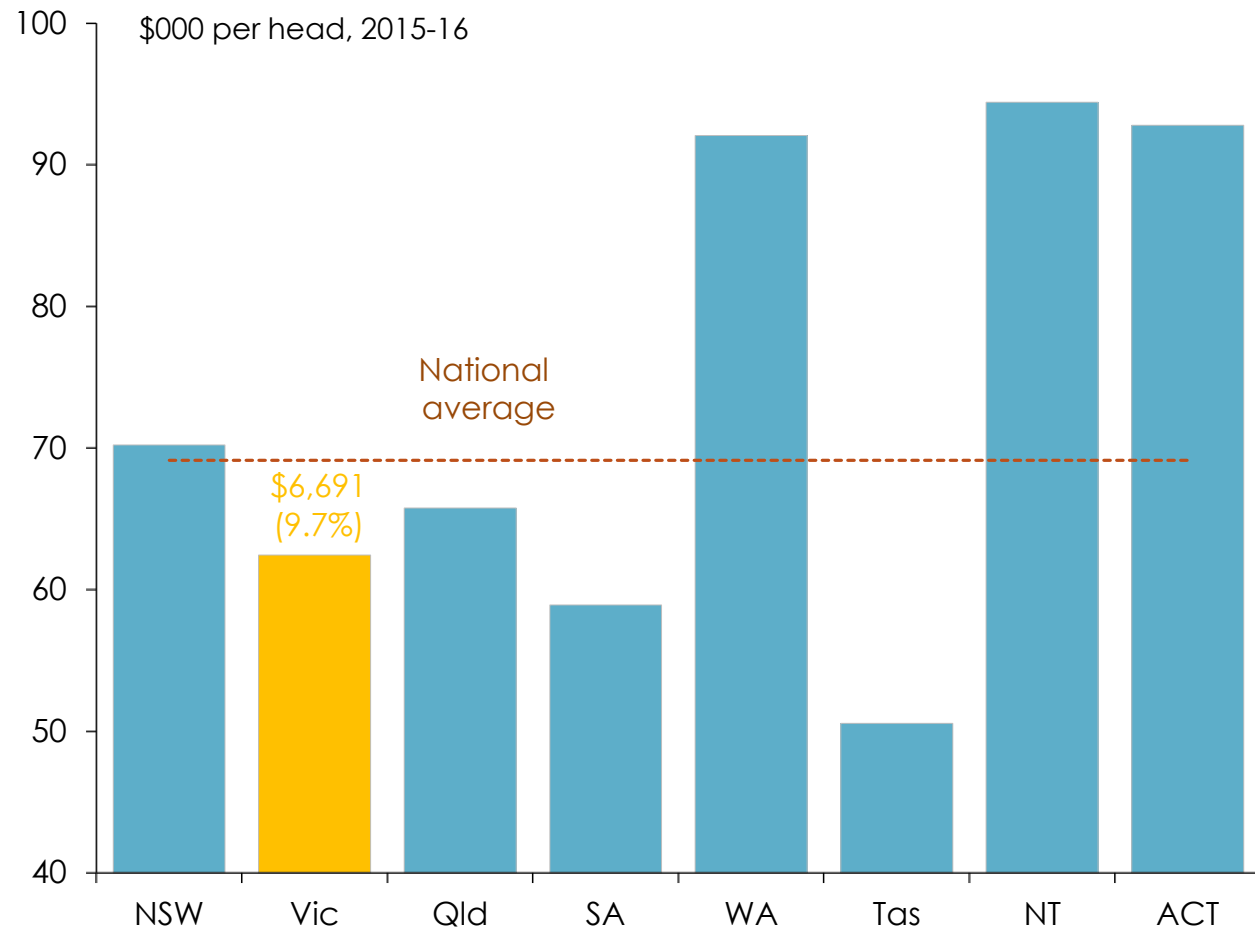
Real gross State product per capita



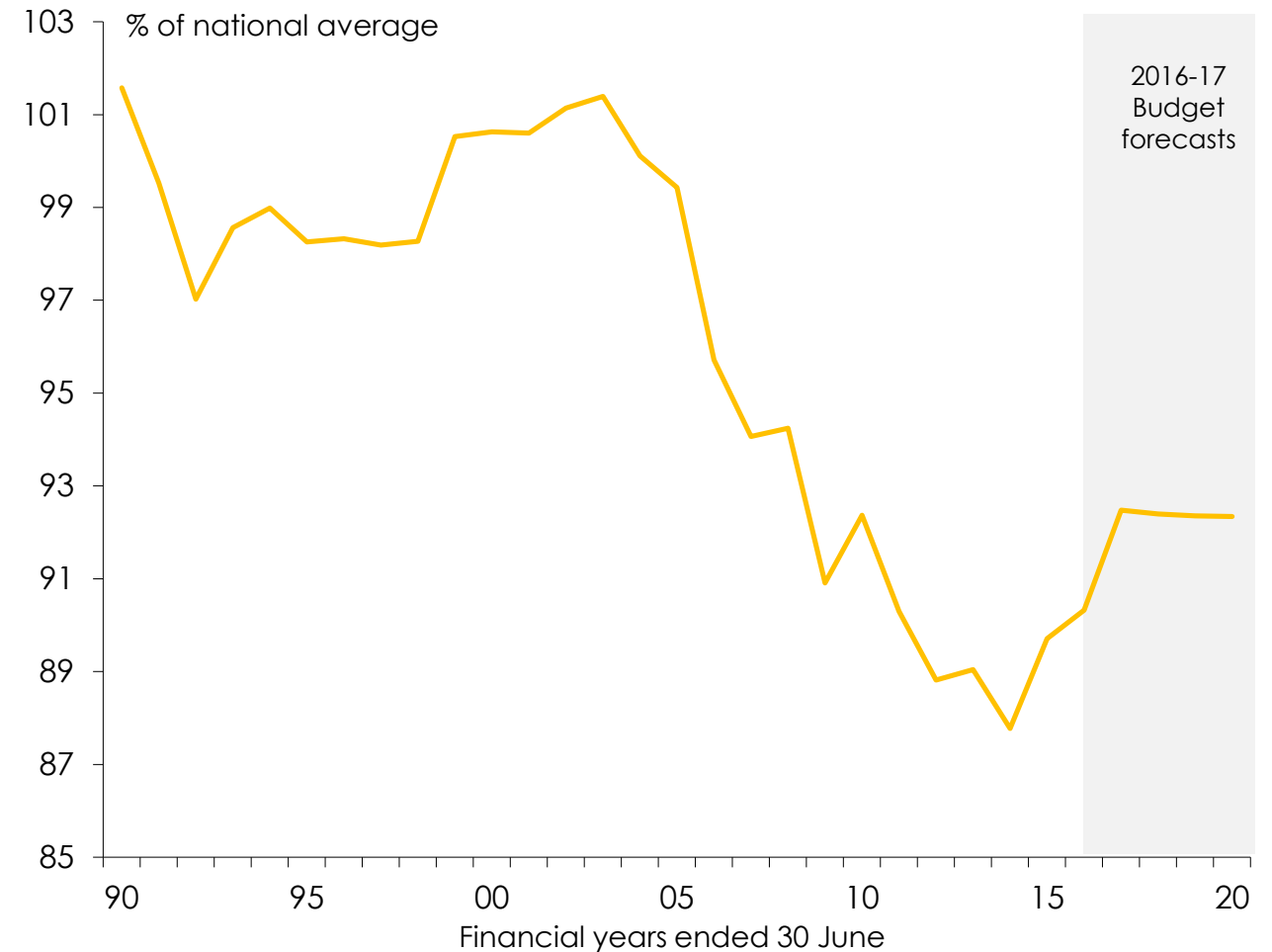
Source: ABS 5206.0 and 5220.0; New South Wales and Victorian Government 2016-17 Budget Papers.

Victoria's per capita gross State product was \$6,700 or 10% below the national average in 2014-15 – and will still be 8% below in 2019-20

Gross State product (GSP) per capita, States & Territories, 2015-16



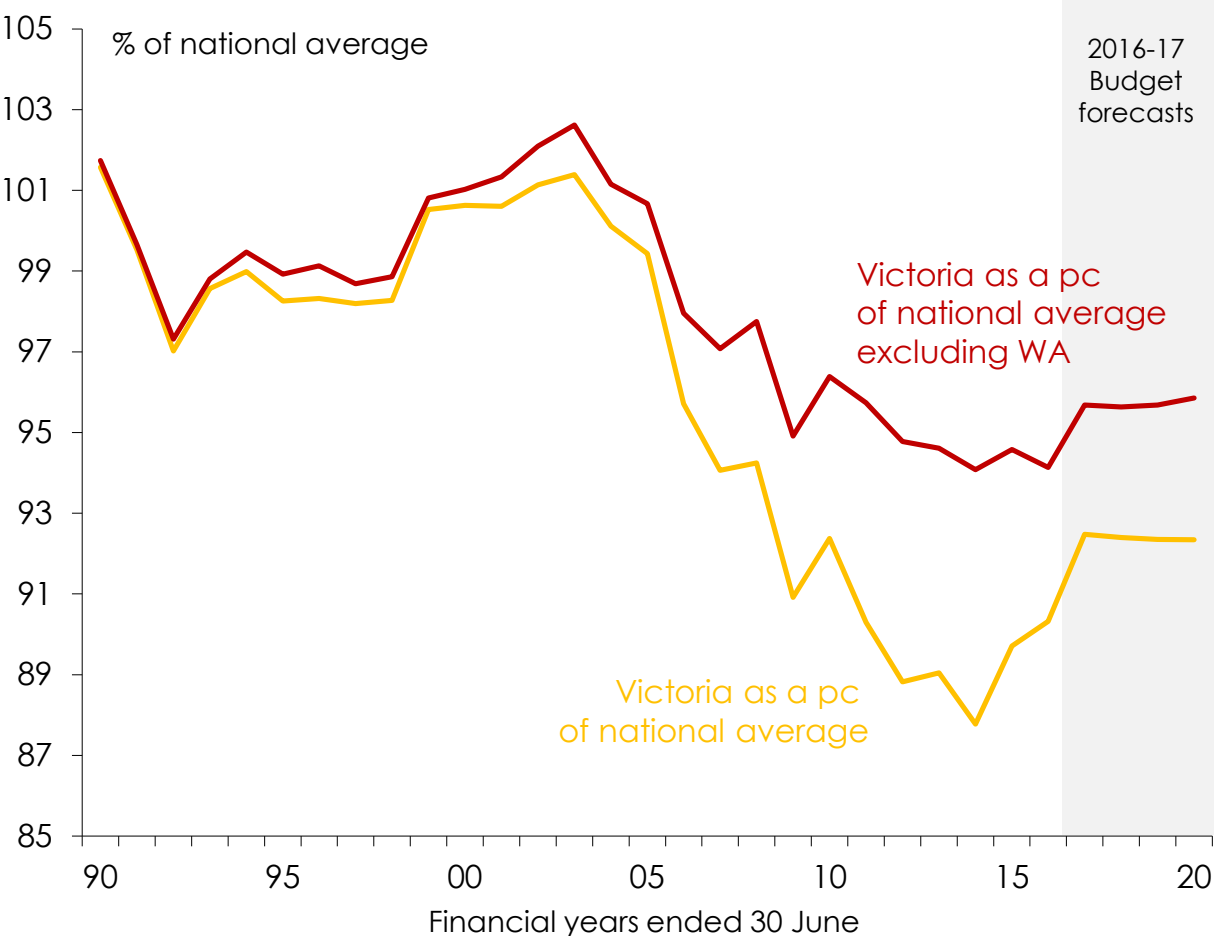
Victorian GSP per capita as a pc of national average, 1989-90 to 2014-15



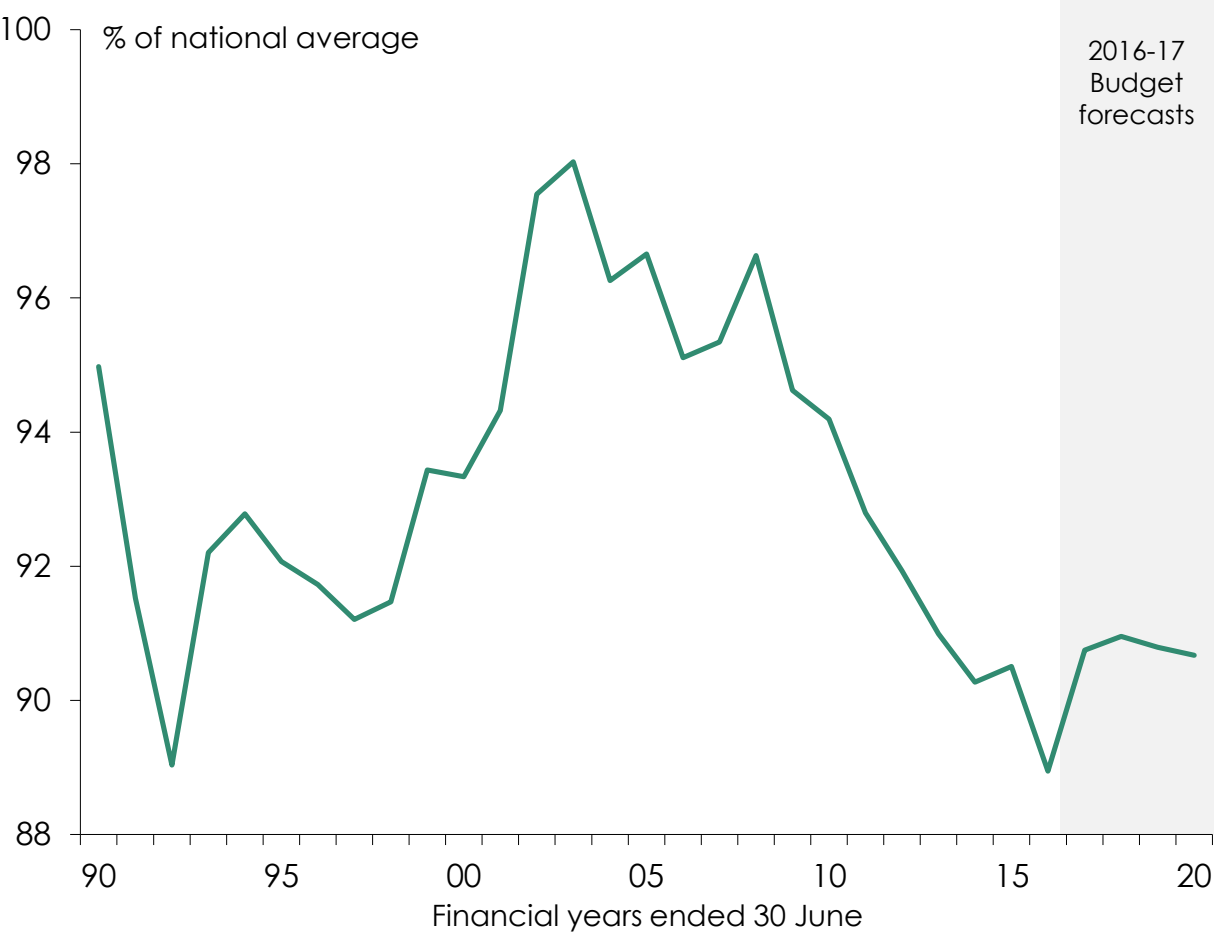
Sources: ABS 5220.0, Australian and Victorian Government 2016-17 Budget Papers.

The decline in Victoria per capita GSP as a pc of the national average is partly a by-product of the mining boom – but that isn't the whole story

Victorian GSP per capita as a pc of national average excluding WA



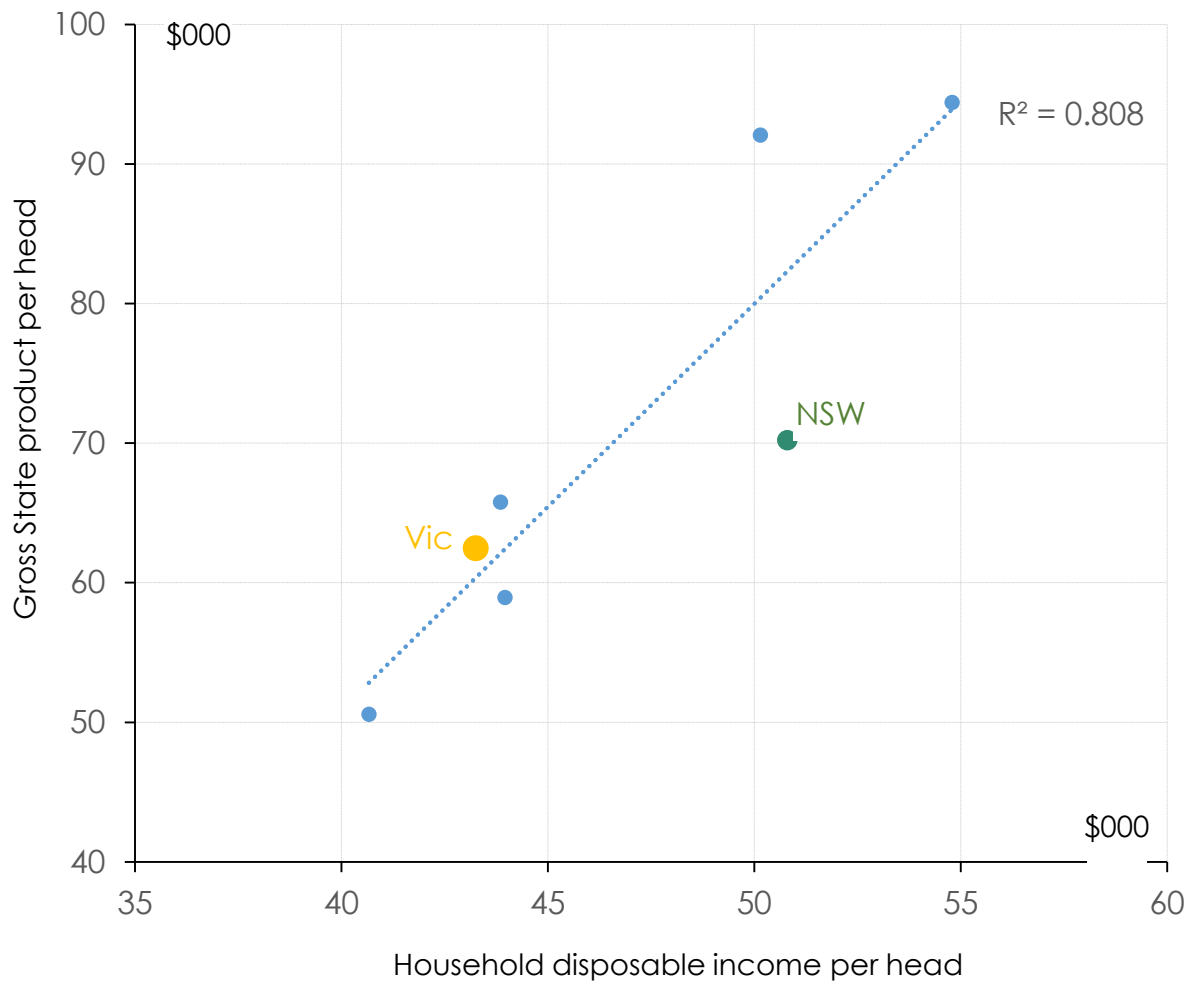
Victorian GSP per capita as a pc of New South Wales



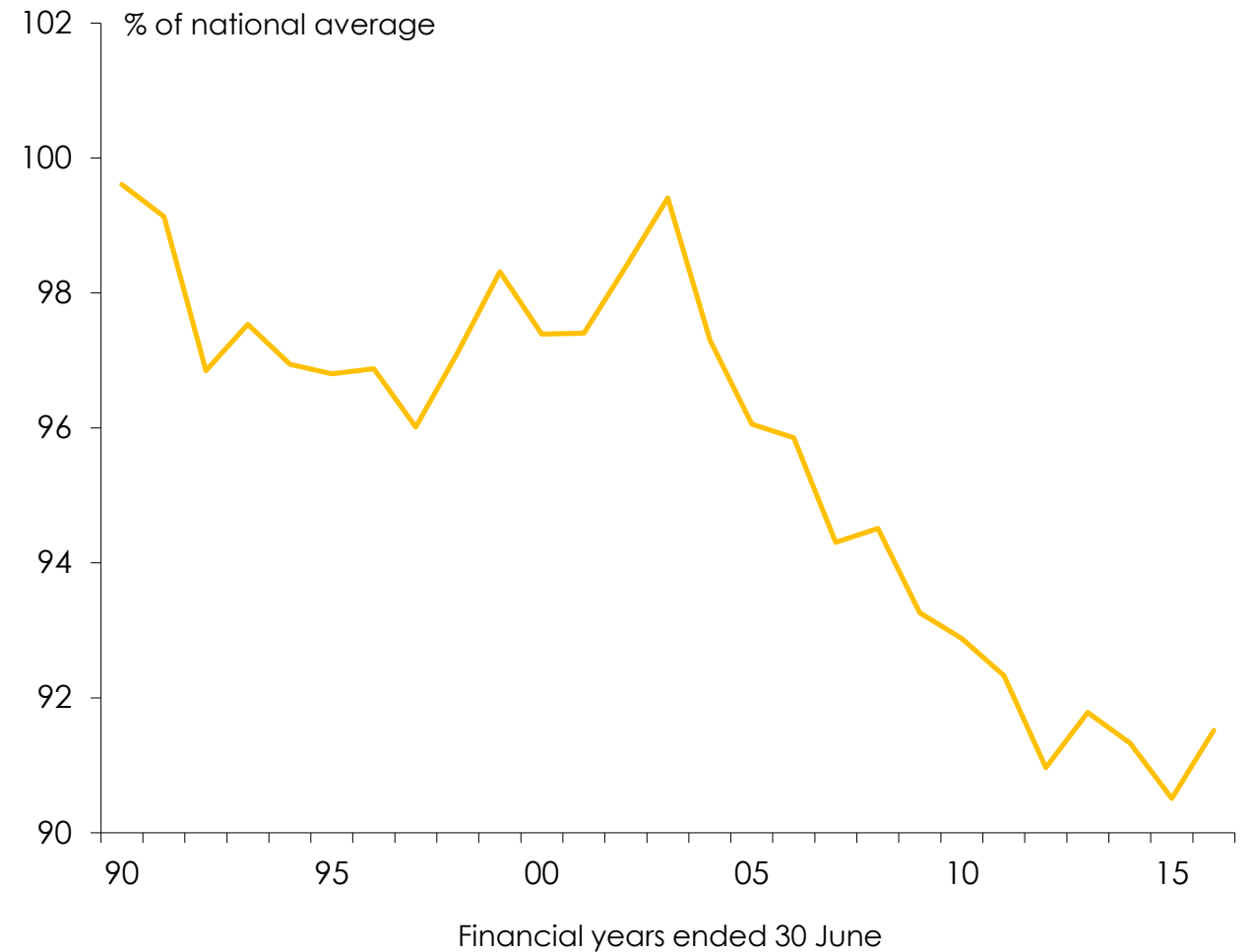
Sources: ABS 5220.0, Australian, Victorian, WA and NSW Government 2016-17 Budget Papers.

Differences in per capita gross product are the major determinant of differences in per capita household income among the States

Gross State product and household disposable income per head, 2015-16



Victorian per capita household disposable income as a pc of national average



Source: ABS 5220.0.

A useful way of thinking about the reasons for Victoria's below-average per capita gross product

$$\frac{\text{gross State product}}{\text{population}} = \frac{\cancel{\text{employment}}}{\text{population}} \times \frac{\text{total hours worked}}{\cancel{\text{employment}}} = \frac{\text{gross State product}}{\text{population}} \times \frac{\text{total hours worked}}{\cancel{\text{employment}}}$$

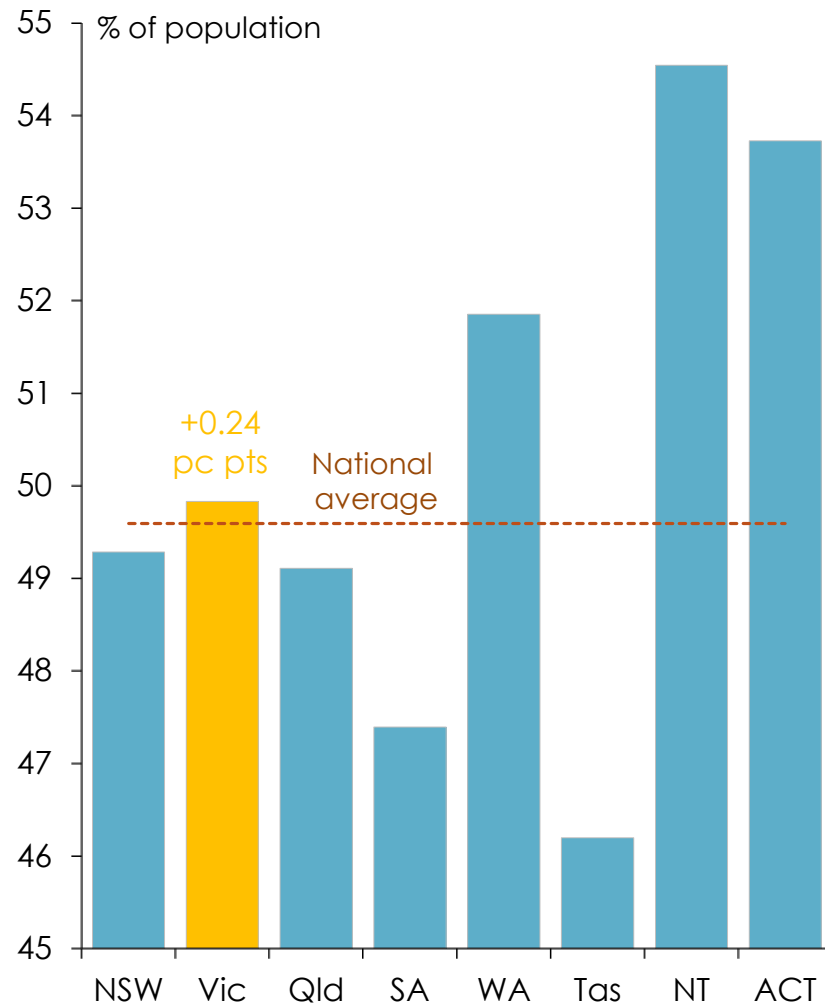
A useful way of thinking about the reasons for Victoria's below-average per capita gross product

$$\frac{\text{gross State product}}{\text{population}} = \frac{\text{employment}}{\text{population}} \times \frac{\text{total hours worked}}{\text{employment}} = \frac{\text{participation rate}}{\text{population}} \times \frac{\text{average hours worked}}{\text{employment}} \times \frac{\text{labour productivity}}{\text{employment}}$$

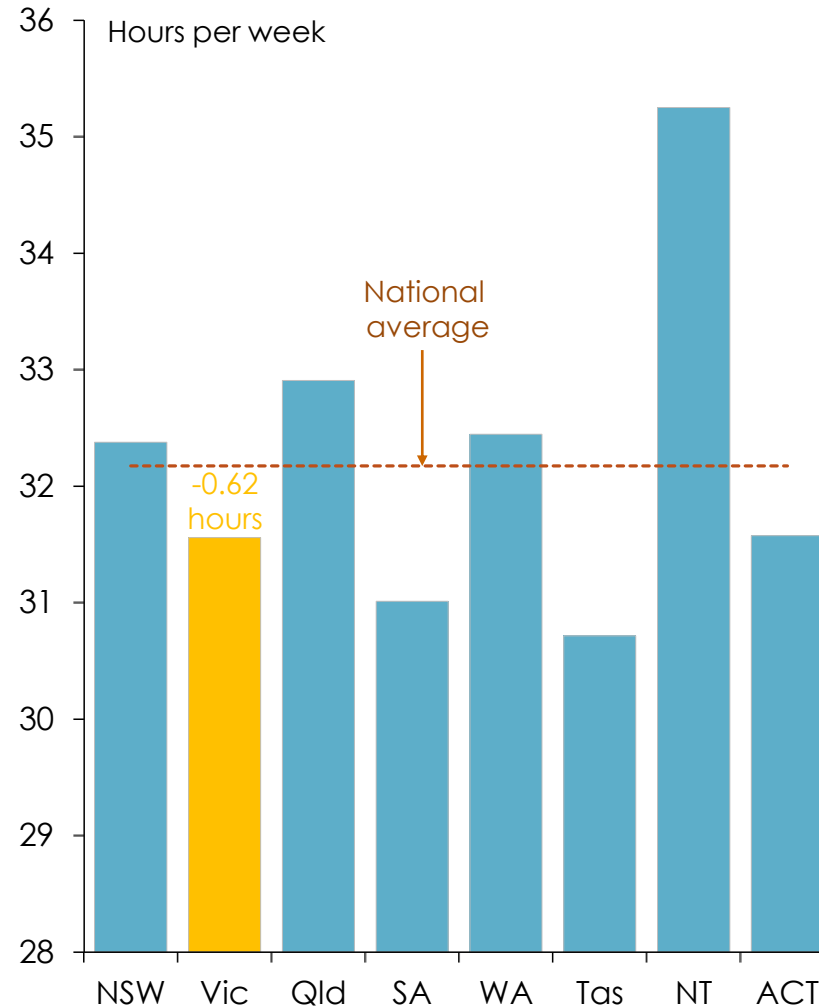
The diagram illustrates the decomposition of per capita gross product into three components: participation rate, average hours worked, and labour productivity. It shows how these factors combine to explain Victoria's below-average per capita gross product.

The effect of Victoria's above-average participation rate is more than offset by below-average working hours and labour productivity

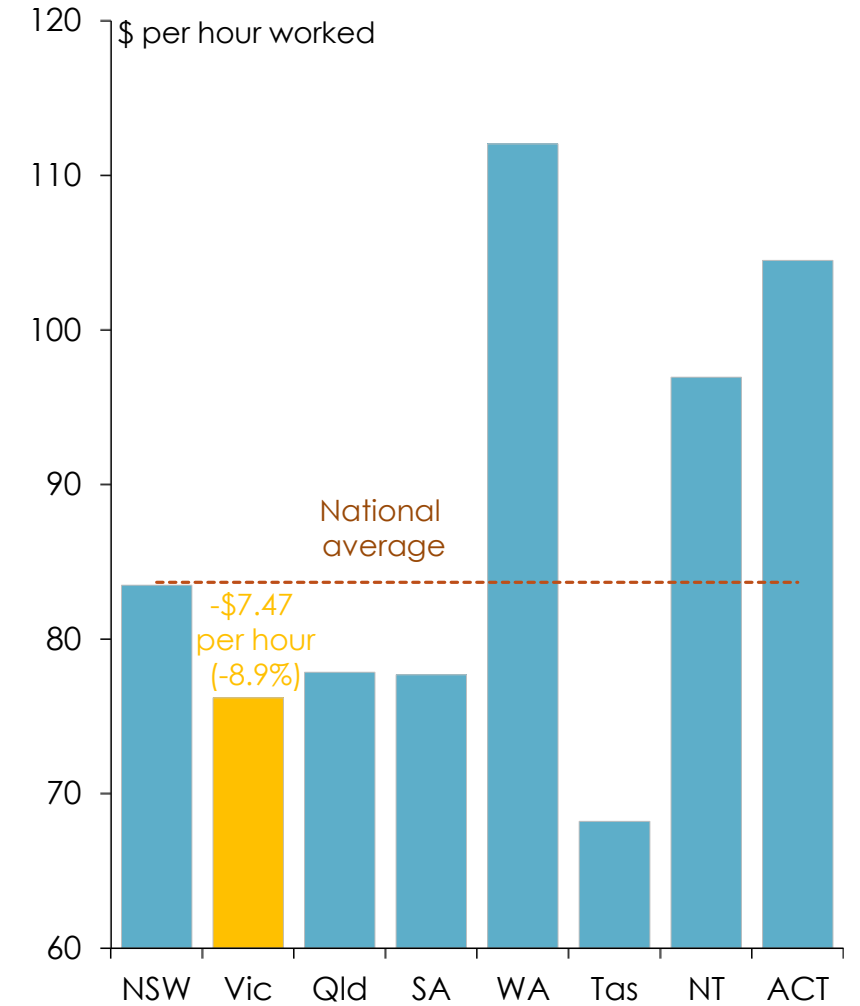
Employment-to-population ratio, 2015-16



Average weekly hours worked, 2015-16



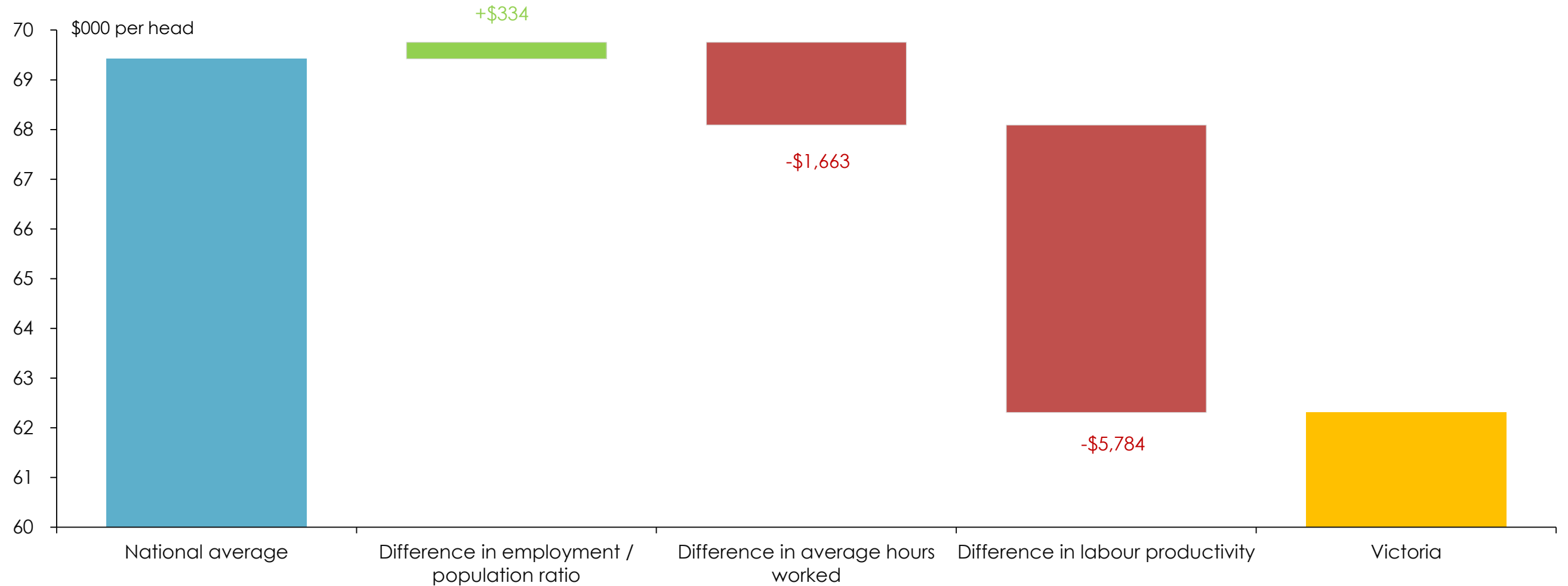
Output per hour worked, 2015-16



Source: ABS 5220.0 and 6202.0

86% of the difference between Victoria's per capita GSP and the national average is attributable to lower labour productivity

Sources of difference between Victorian per capita gross State product and the national average, 2015-16



Note: data shown in this chart are in 2014-15 dollars. Source: ABS 5220.0 and 6202.0

Why does productivity matter?

‘Productivity is the prime determinant in the long run of a nation’s standard of living, for it is the root cause of per capita national income. High productivity not only supports high levels of income but allows citizens the option of choosing more leisure instead of longer working hours. It also creates the national income that is taxed to pay for public services which again boosts the standard of living. The capacity to be highly productive also allows a nation’s firms to meet stringent social standards which improve the standard of living, such as in health and safety, equal opportunity and environmental impact’

— Michael E Porter, *The Competitive Advantage of Nations* (1991)

‘Productivity ... isn’t everything, but in the long run it’s nearly everything’

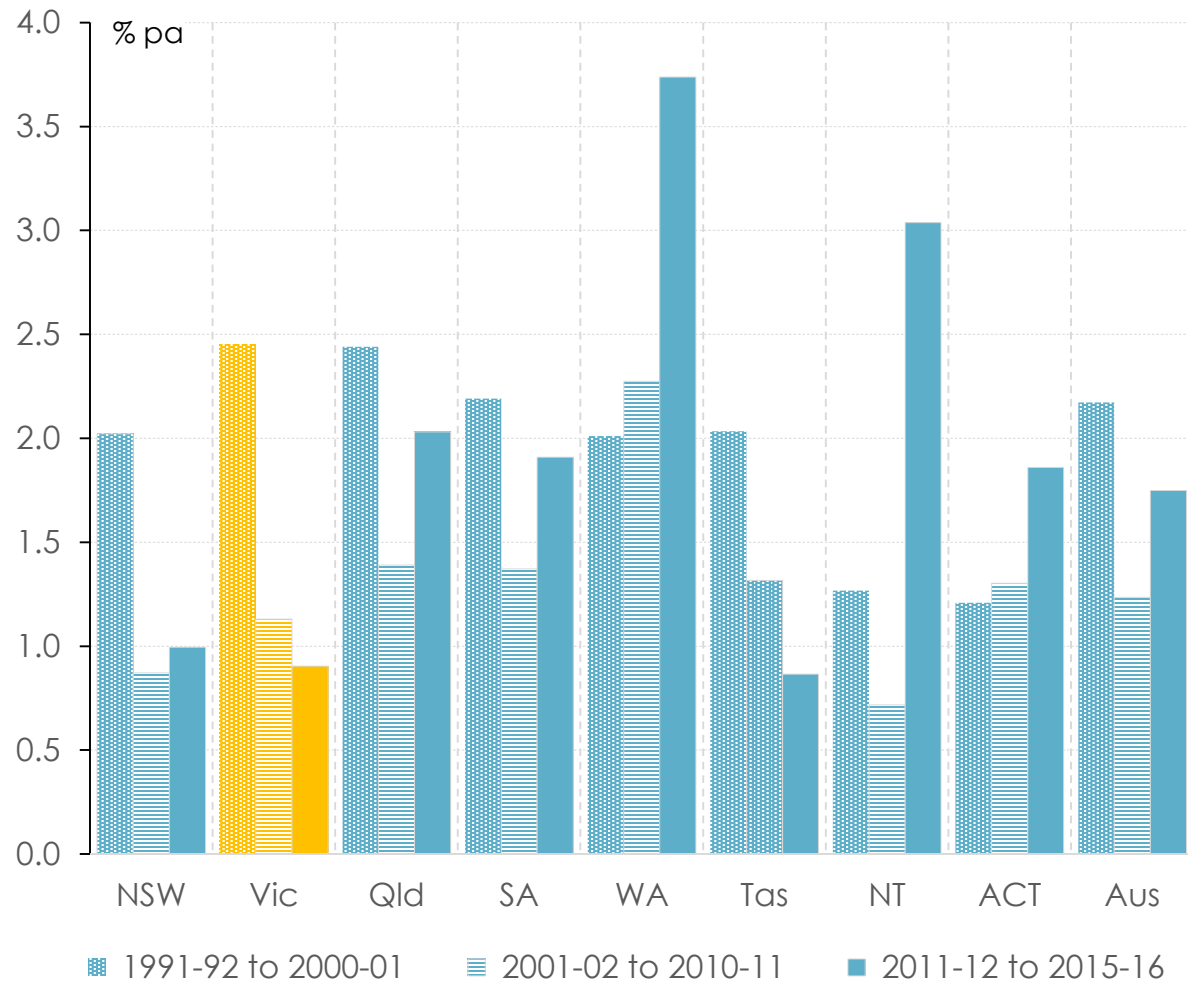
— Paul Krugman, *The Age of Diminished Expectations* (1994)

‘There is only one source of ongoing higher rates of growth of real per capita incomes, and that is higher rates of growth of productivity’

— Glenn Stevens, ‘The cautious consumer’, Address to the Anika Foundation (2011)

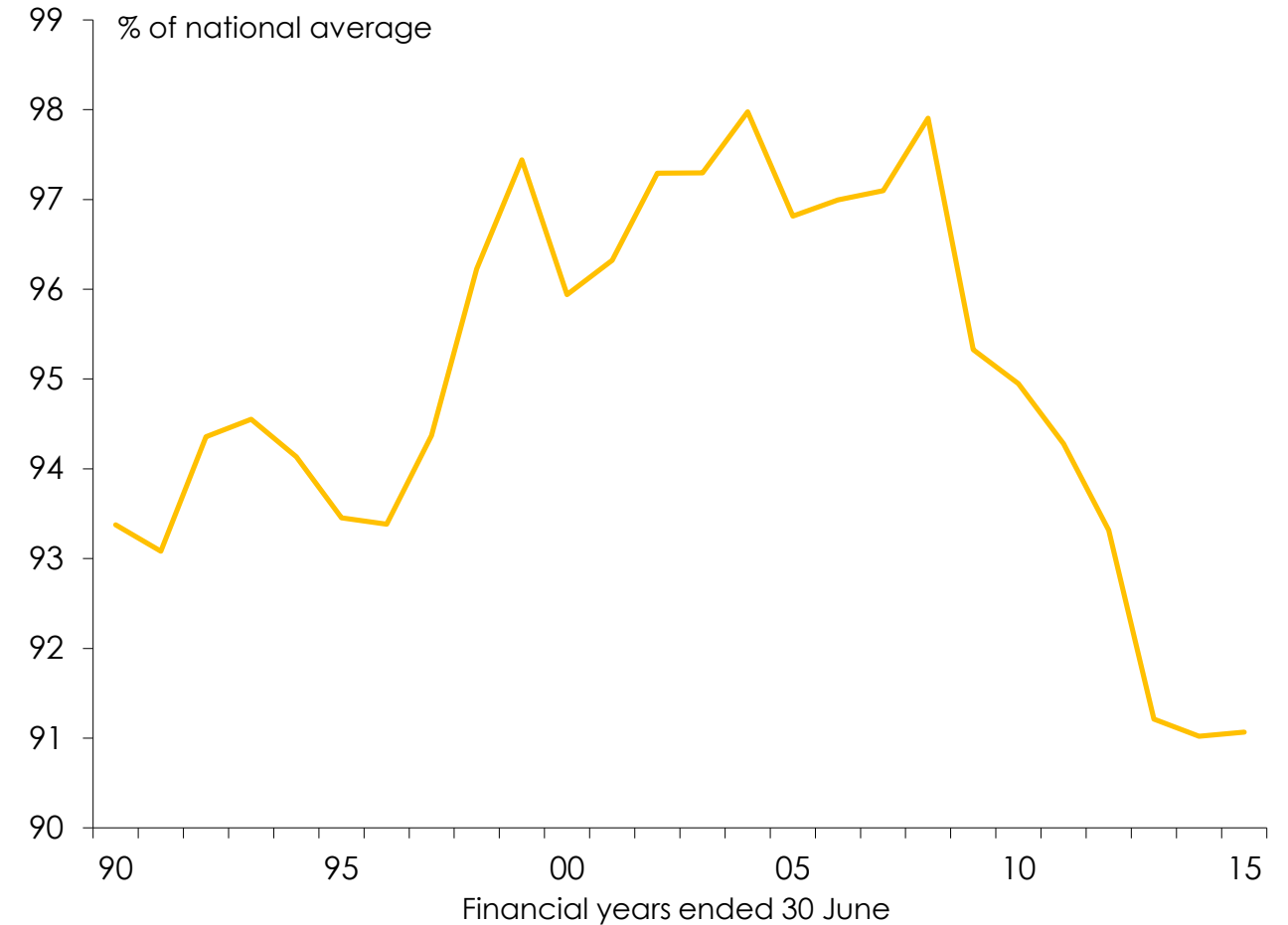
Labour productivity growth in Victoria has slowed relative to the rest of Australia since 2010-11

Labour productivity growth, States and Territories



Sources: ABS 5220.0.

Victorian labour productivity as a pc of the national average

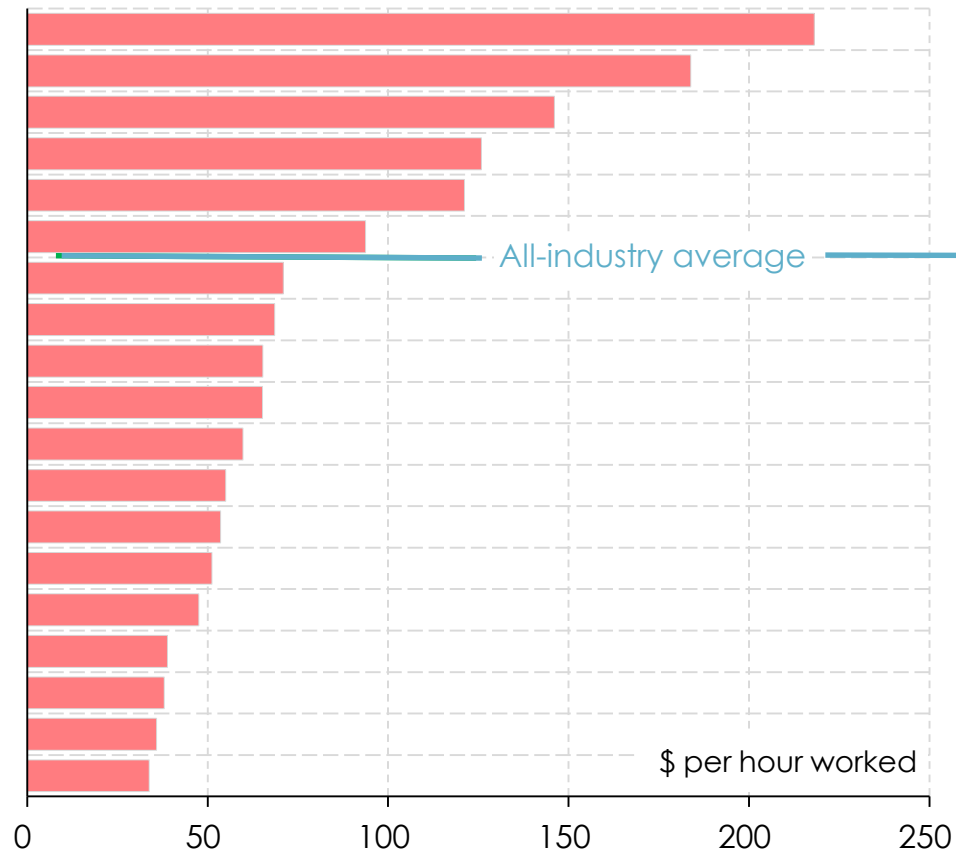


Three 'top down' reasons for Victoria's poor labour productivity performance

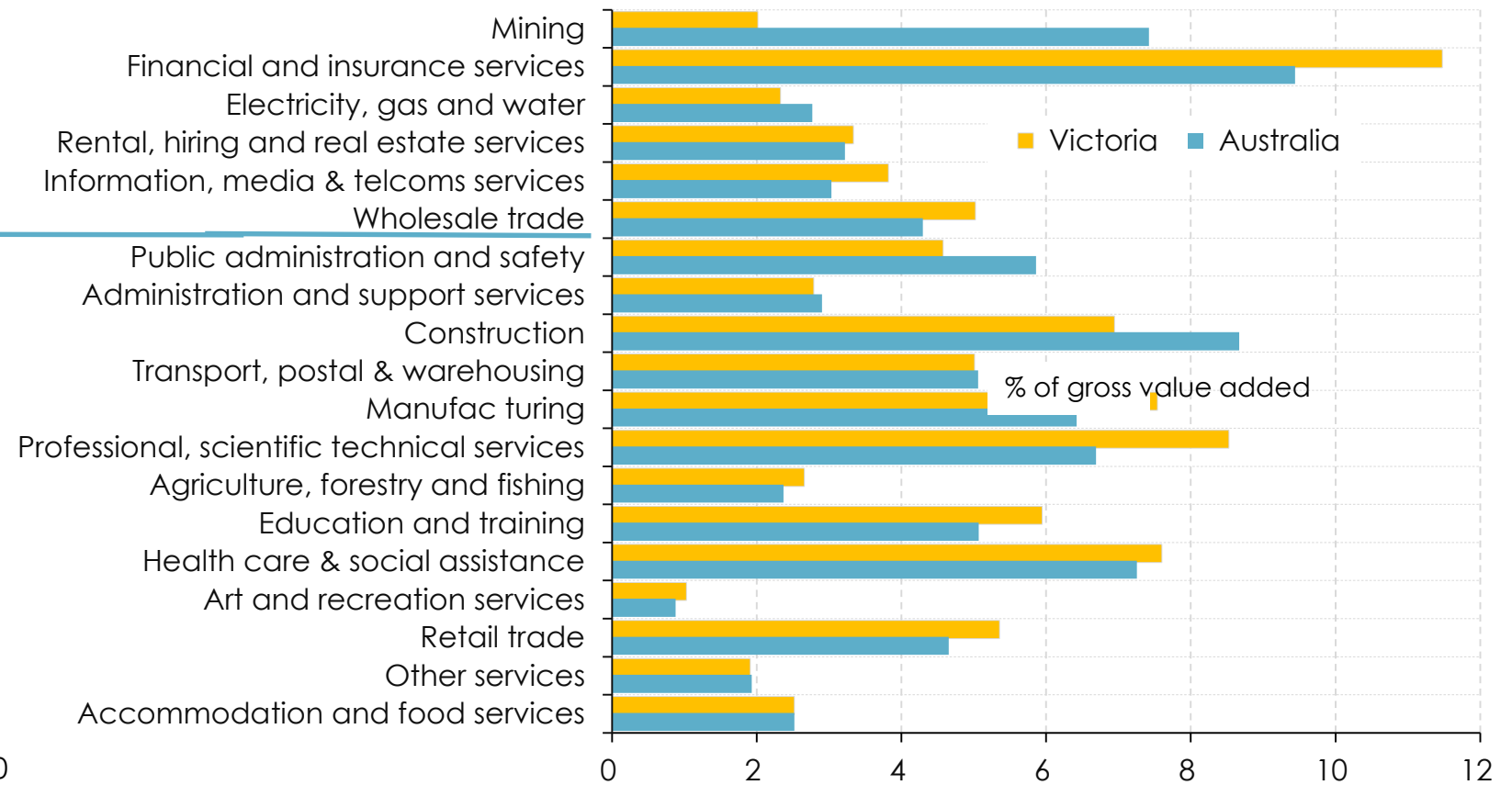
- ❑ Victoria has a below-average share of 'high productivity' industries
- ❑ A majority of Victorians work in industries where labour productivity in Victoria is lower than the corresponding national average level of labour productivity for those industries
- ❑ Labour productivity growth has slowed by more, across a larger proportion of the Victorian economy, than has been the case nationally

One reason for Victoria's below-average productivity is that it has a below-average share of industries with above-average productivity

Labour productivity by industry, Australia, 2015-16



Industry shares of gross value added, Victoria and Australia, 2015-16

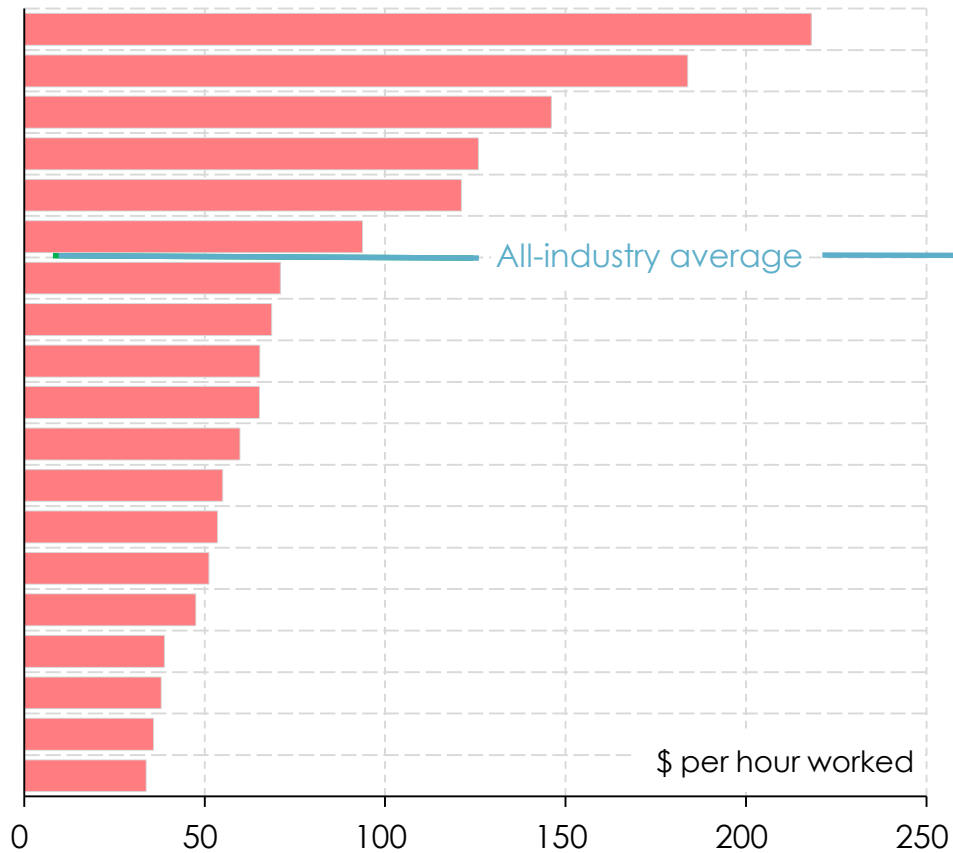


The six sectors which, at the national level, have above-average levels of labour productivity, account for 28% of Victoria's total gross value added – 2 pc points below their share of the national economy (cf. 31% of NSW's and 41% of WA's)

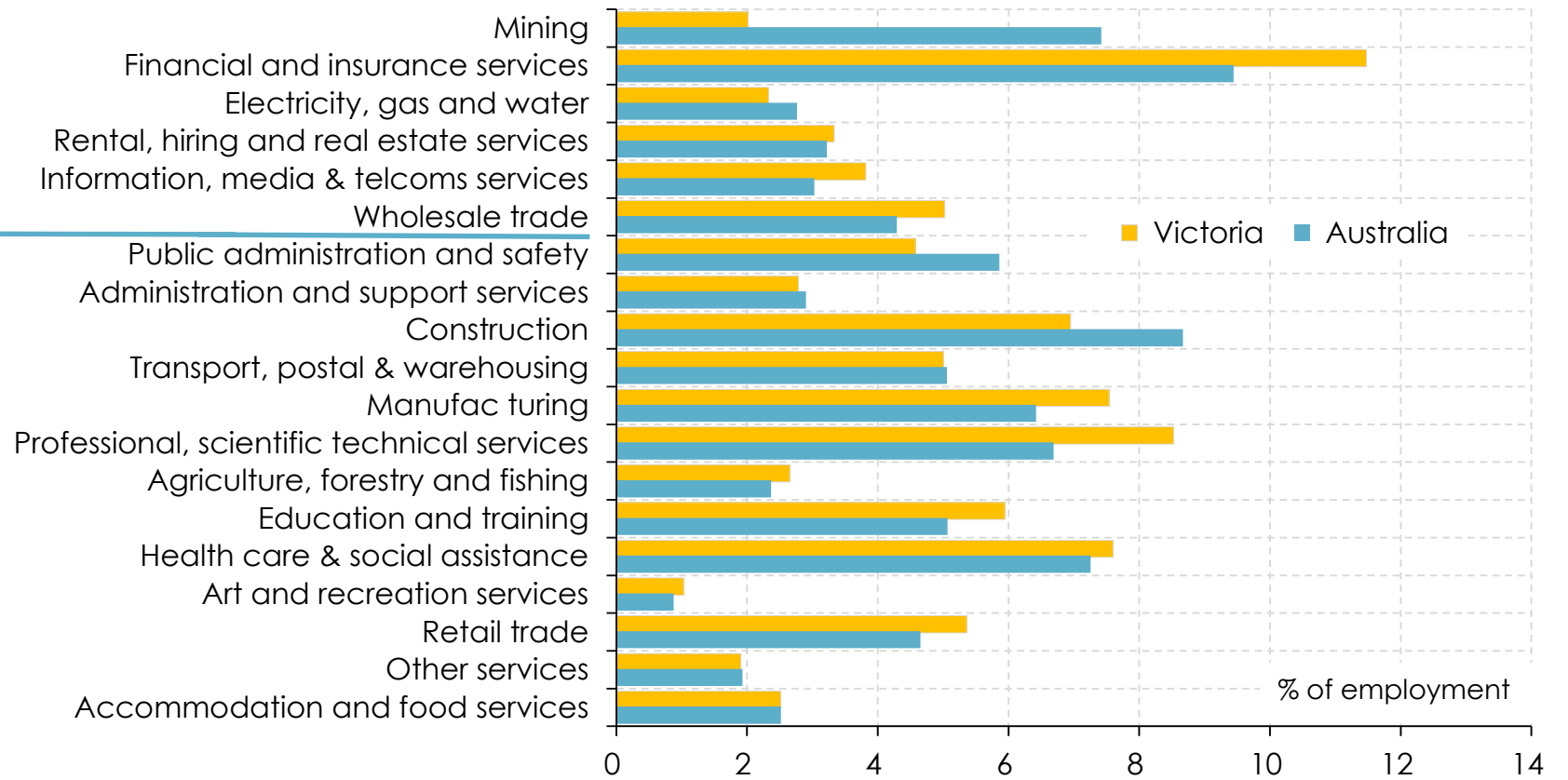
Note: Gross value added is gross State or domestic product excluding ownership of dwellings. Sources: ABS 5206.0, 5220.0 and 6291.0.55.003

One reason for Victoria's below-average productivity is that it has a below-average share of industries with above-average productivity

Labour productivity by industry, Australia, 2015-16



Industry shares of employment, Victoria and Australia, 2015-16

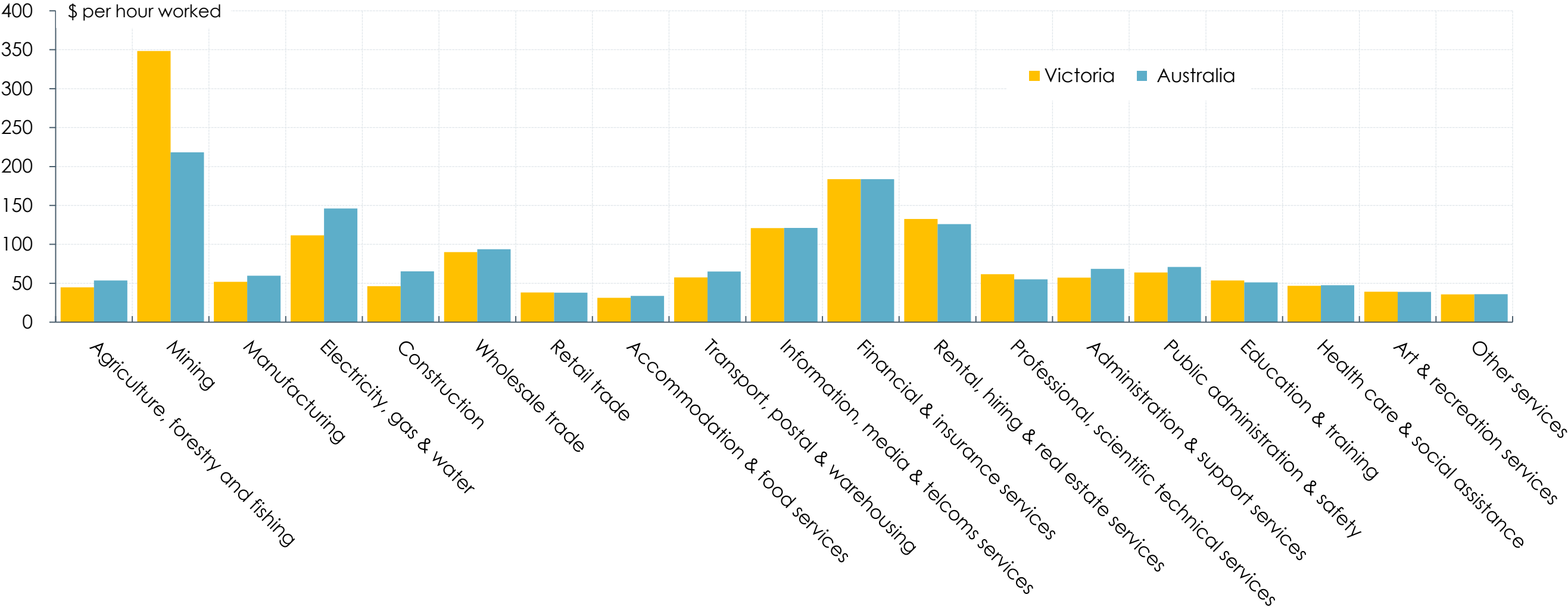


The six sectors which, at the national level, have above-average levels of labour productivity, account for 12.3% of Victoria's employment – 4.1 pc points below their share of national employment (cf. 14.6% of NSW's, and 16.8% of WA's)

Sources: ABS 5206.0, 5220.0 and 6291.0.55.003

In addition, labour productivity is below the national average in 10 of Victoria's 19 industry sectors – and clearly above in only two sectors

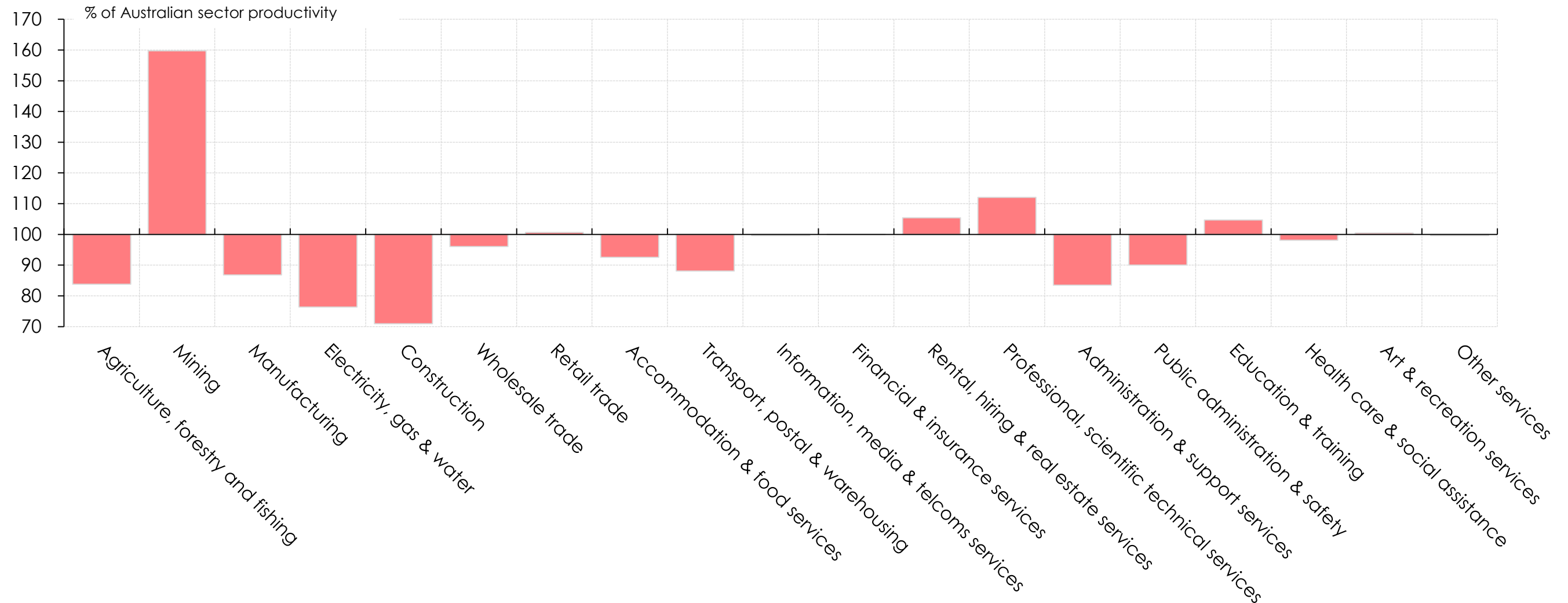
Labour productivity by industry, Victoria and Australia, 2015-16



Source: ABS 5220.0 and 6202.0

Labour productivity is below the national average in 10 of Victoria's 19 industry sectors – and clearly above average in only two sectors

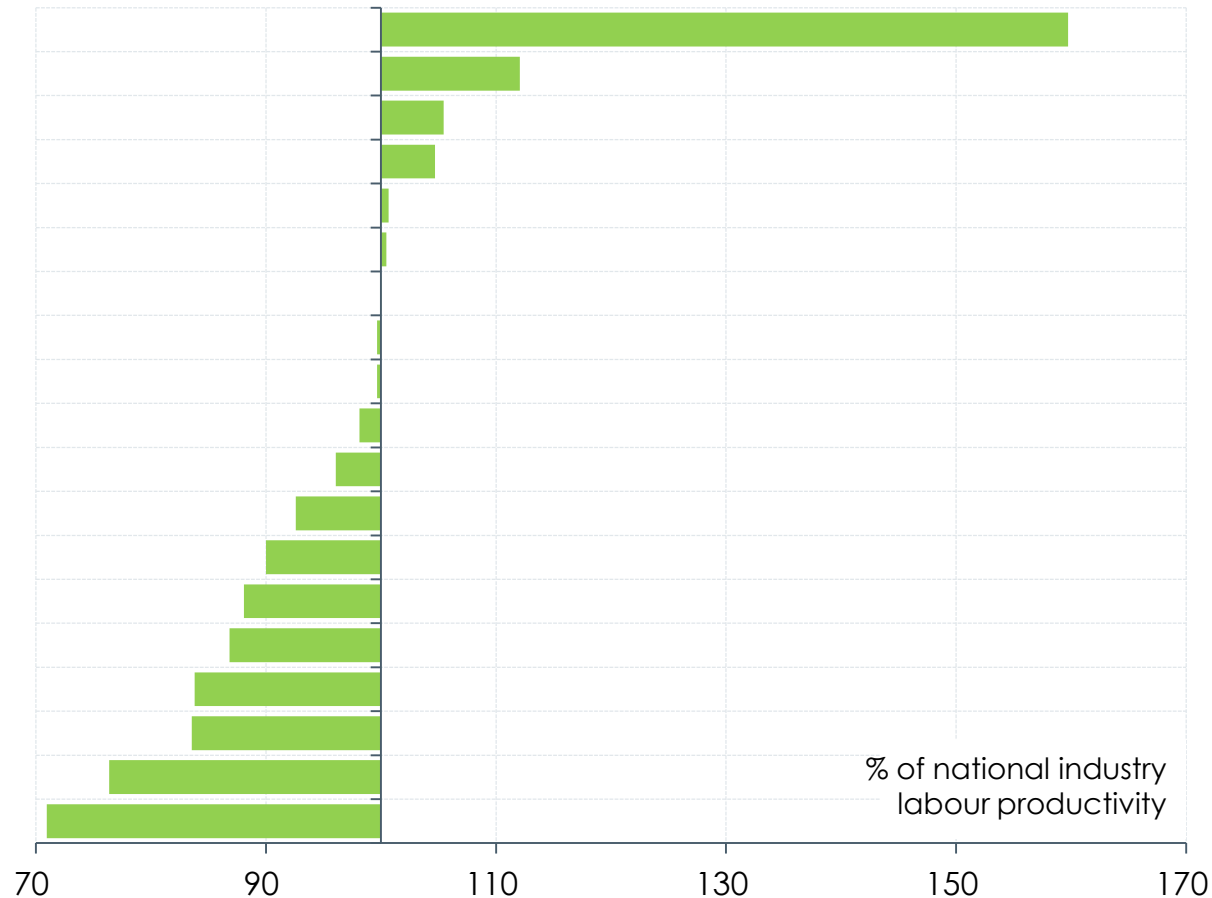
Labour productivity in Victorian industries as a pc of labour productivity in corresponding national industries, 2015-16



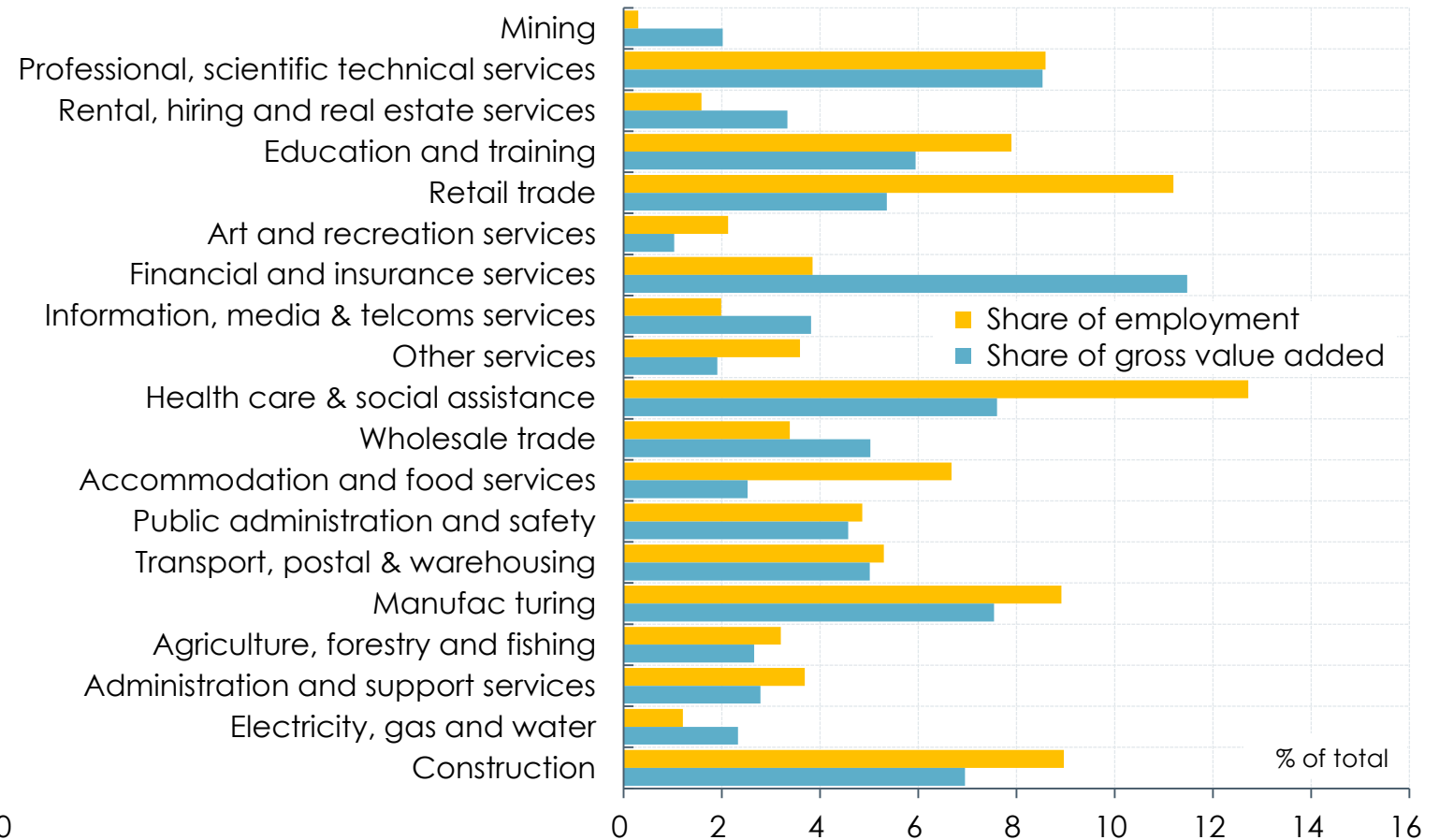
Source: ABS 5220.0 and 6202.0

65% of employed Victorians work in industries where labour productivity is below the national average for that industry

Labour productivity in Victorian industries as pc of national averages, 2014-15



Industry shares of employment and value added, Victoria, 2014-15

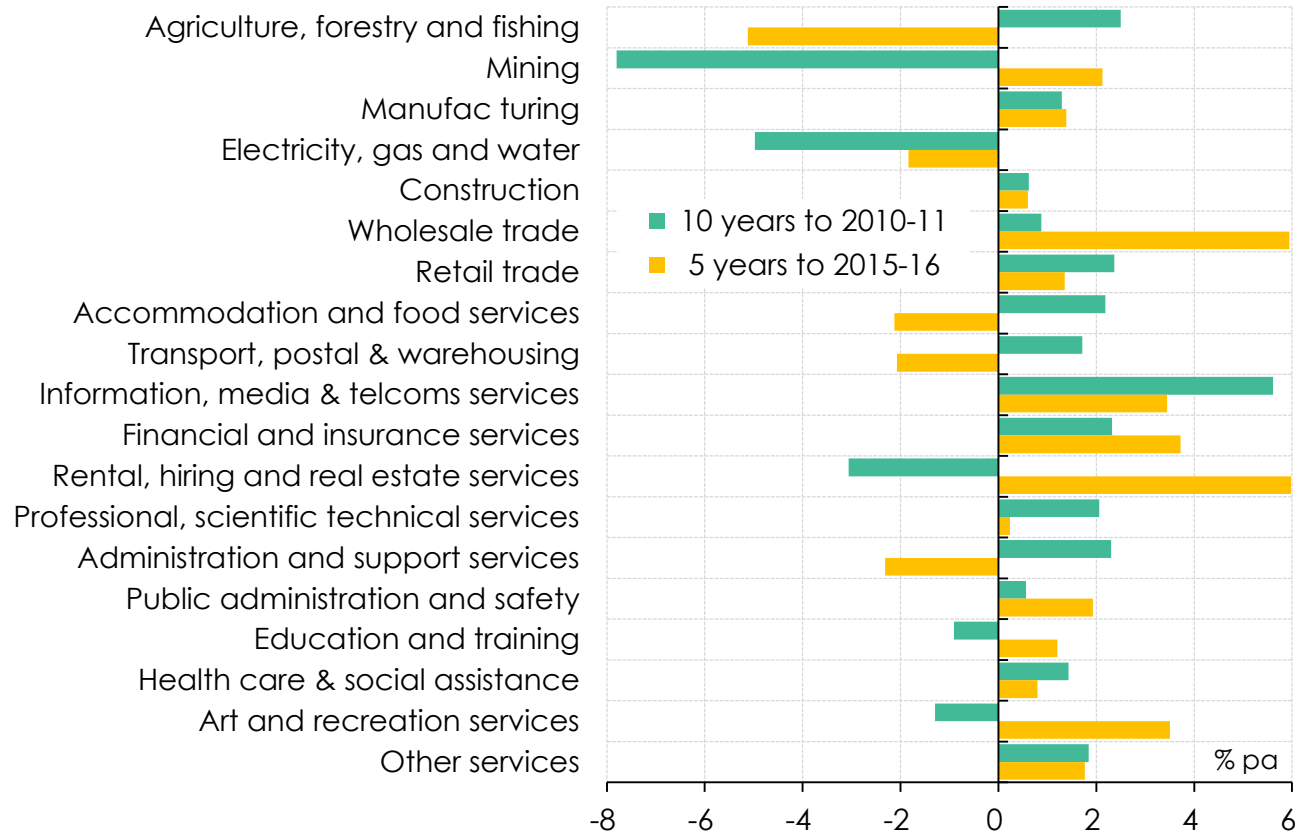


65% of employed Victorians work in industries where labour productivity is below the corresponding national industry level. The equivalent figure for NSW is 41%.

Sources: ABS 5206.0, 5220.0 and 6291.0.55.003

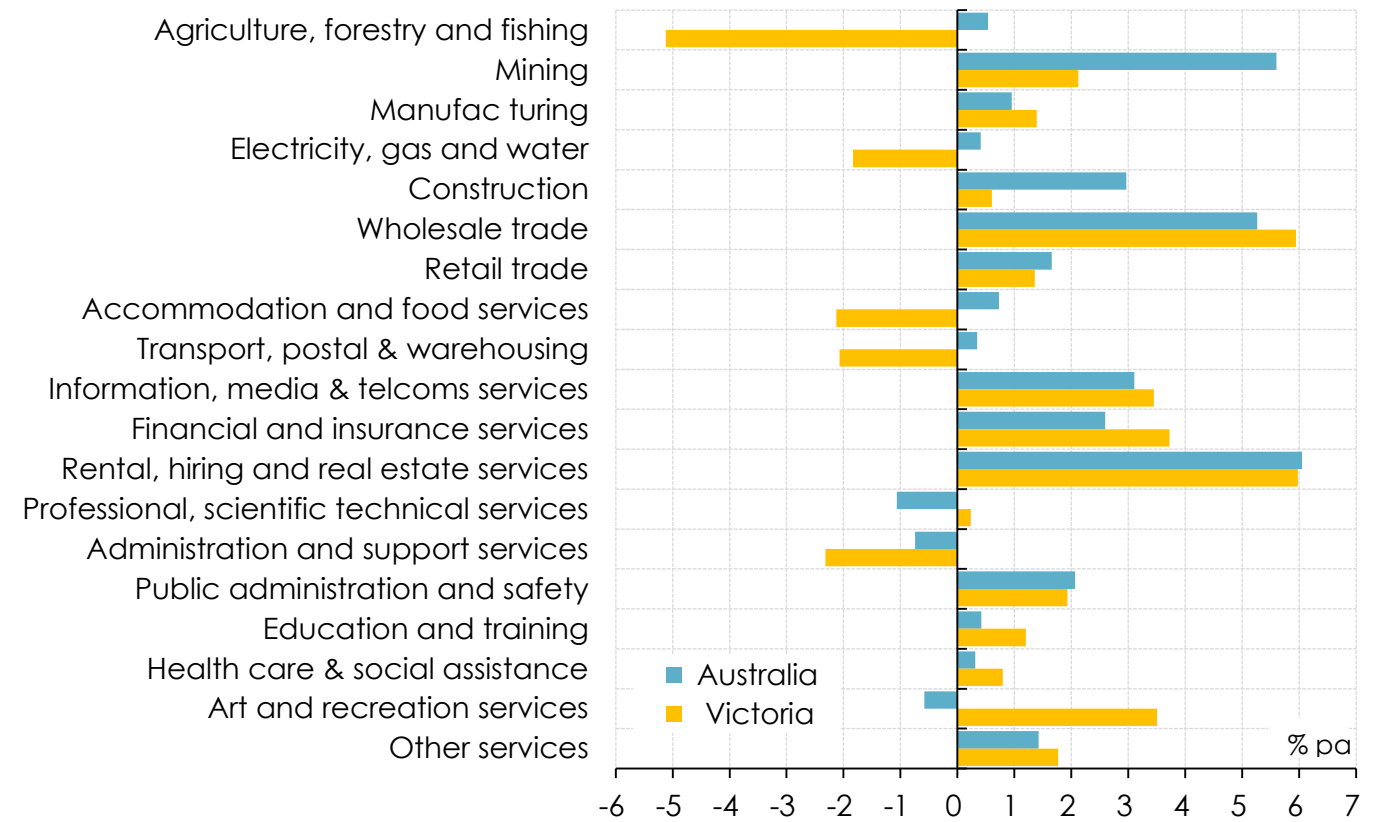
Productivity growth has slowed, and been lower than the national average, in a larger share of Victorian industries over the past five years

Victorian labour productivity growth by industry, past five and previous ten years



Labour productivity growth has slowed over the past five years compared with the previous ten, in 10 out of 19 Victorian industries employing 66% of the workforce

Victorian & Australian labour productivity growth by industry, past five years

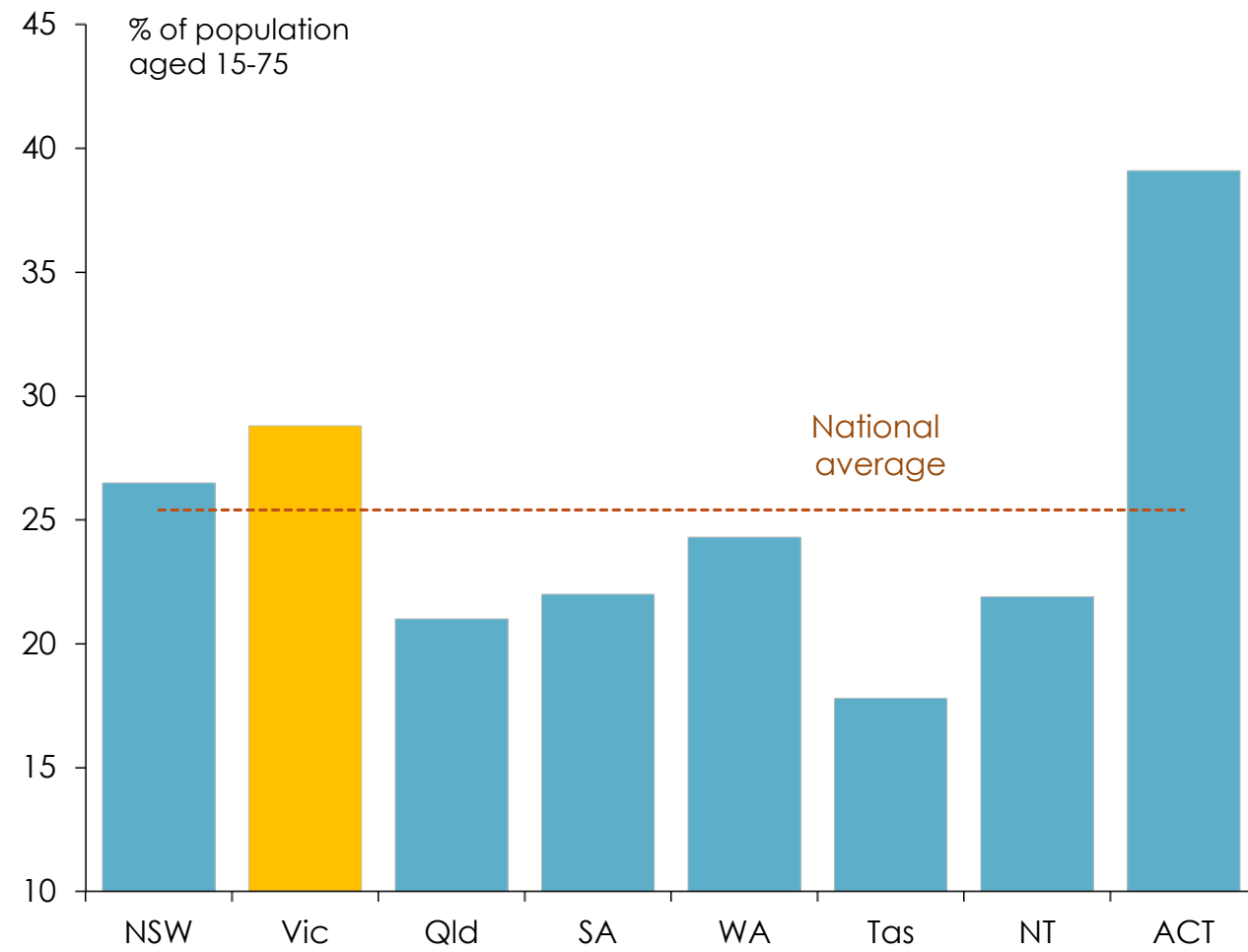


Labour productivity growth has been below the national average over the past five years in 10 of 19 Victorian industries employing 47% of the workforce

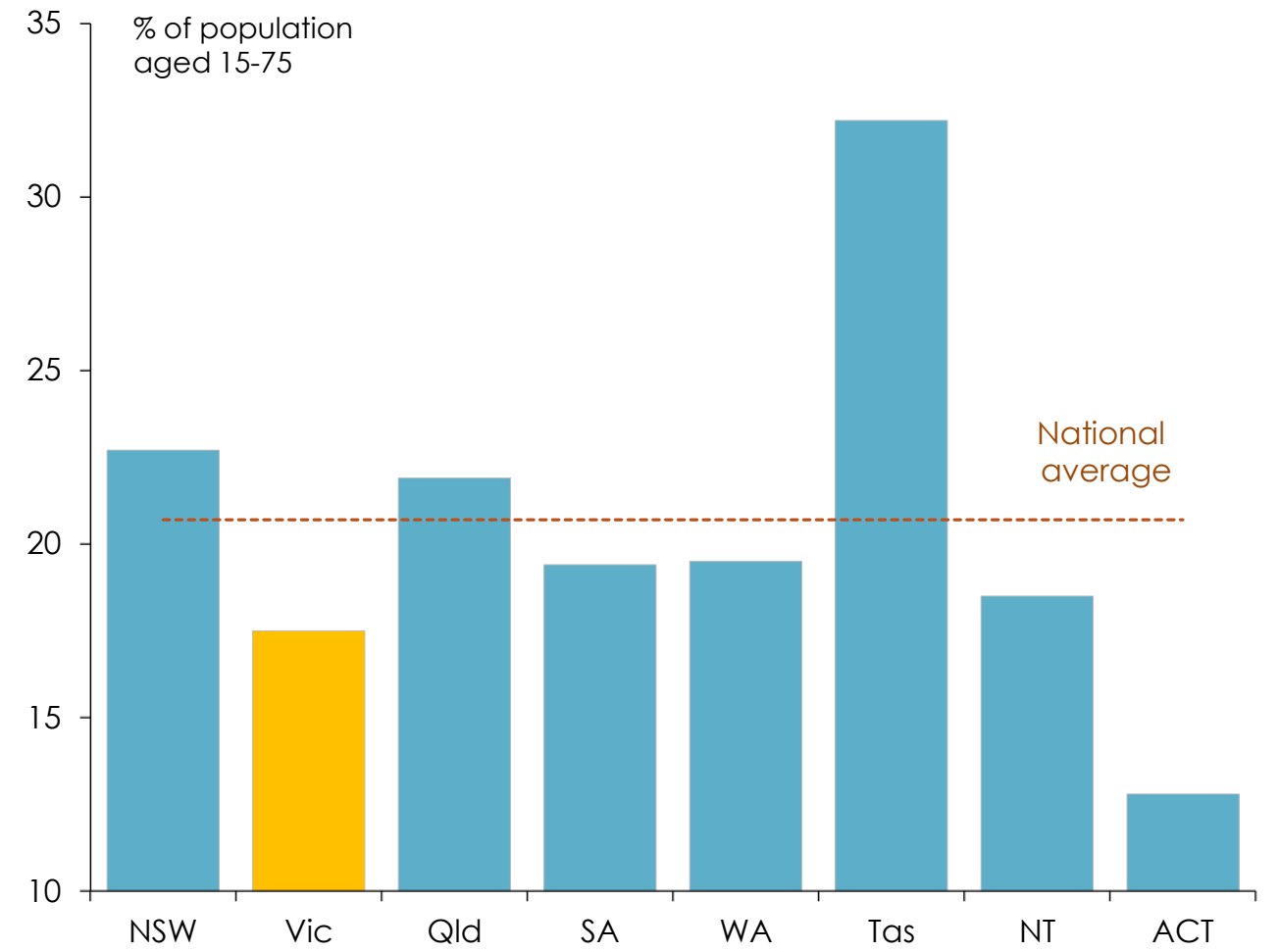
Sources: ABS 5206.0, 5220.0 and 6291.0.55.003

Unlike Tasmania, Victoria's below-average labour productivity clearly isn't the result of low levels of educational attainment and performance

Proportion of population with bachelor's degree or higher, May 2015



Proportion of population with no qualification beyond Year 10 of high school, May 2015



Source: ABS 6227.0.

What other 'bottom-up' reasons might there be for Victoria's below-average labour productivity?

❑ Infrastructure deficits

- increased traffic congestion, 'bottlenecks' at ports and airports, or inadequacies in other key economic 'enablers', could be detracting from productivity in sectors such as transport, manufacturing, professional and business services

❑ Work practices

- may be a factor in (for example) construction where labour productivity in Victoria is 24% below the national average for construction

❑ Management practices

- possible that Victorian businesses are less 'innovative' in various ways than businesses in some other States – perhaps because exports represent a smaller share of Victoria's gross product than that of any other State or Territory

❑ Regulation

- A VCEC Inquiry in 2011* found that 'the Victorian regulatory system can make a more effective and focussed contribution to Victoria's competitiveness, productivity growth and liveability, and it is important that it does so'

* Victorian Competition and Efficiency Commission, *Strengthening the Foundations for the Next Decade: An Inquiry into Victoria's Regulatory Framework*, Final Report April 2011.

For more details...

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